Regulatory Intervention To Impose Bill-And-Keep Harms Consumers And May Cause Further Market Failures

Unintended And Negative Consequences Will Result From Dramatic Change in Regulatory Policies To Impose Bill-and-Keep for All Calls.

1. Consumer Harm:

- Average increase of $60 in Kansas and $85 in Oklahoma, per line per month for ILEC customers to recover interconnection revenues. Unlikely that this increase will be offset for most, if any, customers by originating rate decreases by service providers.
- Increasing network congestion and deteorating service quality.
- Declining deployment of new network services and facilities.

2. Competitive Harm:

- CLECs with more terminating than originating usage may leave the market because they are unable to recover terminating costs from end users.
- CLECs may focus business plans on customers that originate calls to avoid terminating charges and to gain a competitive advantage.
- CLECs are not incented to serve all end users.
- If terminating costs are charged to all end users, customers receiving no CLEC and/or CMRS and/or toll calls are forced, at odds with provisions of the Act, to subsidize end users receiving these calls and/or the service provider – end users inappropriately subsidize competitive entry.

3. Harm To ILEC Network Provider:

- Significant loss of revenue which recovers transport and termination costs – may not be recoverable from end users.
- Pressure to add new facilities due to inefficient originating calling. May not be able to recover costs from terminating end users.
- Loss of revenues may lead to network congestion, lower service quality and inability to provide new technologies such as broadband and even inability to perform carrier of last resort obligations.
- Transiting providers have no means to recover their costs and consequently have no incentive to provide facilities for indirect interconnection.

Lack of Clarity in FCC Policies Plus a Misunderstanding of the Existing Compensation Regime and Misinterpretation of FCC Policies by State Commissions Are Beginning To Have Negative Consequences

a) <u>CMRS Interconnection</u> (See Attachments to FW&A and KCPR reply comments filed on 8-19-2002 in Docket No. 01-92, DA02-1740):

- CMRS providers are inappropriately delivering traffic for termination without seeking an interconnection agreement and without offering to pay for the facilities used to terminate their calls (de facto bill-and-keep).
- When an interconnection agreement is sought by the ILEC, CMRS providers supported by FCC policies as interpreted by certain state commissions, require ILECs who provide no service beyond their local exchange boundary to:
  1. Treat IXC presubscribed traffic that is originated and terminated within an MTA as if it were ILEC local traffic.
  2. This treatment is at odds with the Act and FCC rules which (a) require that this traffic be handed off to a customer's presubscribed carrier and (b) exempts this IXC traffic from intraMTA reciprocal compensation requirements because the IXC, not the ILEC is the service provider.
- The negative consequences are that:
  1. IXCs lose traffic and toll revenues and are further discented from providing service in rural markets served by ILECs. In Oklahoma, this loss is approximately $2 million for calls originated in rural ILEC exchanges.
  2. ILECs lose access revenue on these calls and instead, are required to pay (assuming bill-and-keep is not imposed) terminating reciprocal compensation to CMRS providers. These costs will, if possible, be recovered from end users and amount to an estimated $2.50 per loop per month for every ILEC customer in Oklahoma. ILEC customers inappropriately are caused to subsidize CMRS providers.
  3. If bill-and-keep is imposed by a state commission (even though a traffic imbalance is proven), lost ILEC revenues (originating and terminating) and the additional terminating and transiting payments can only be recovered from

the ILECs end users. If ILECs are precluded from recovering these costs and lost revenues, they have little incentive to place additional interconnection facilities and if the losses are severe enough, may be unable to continue placing broadband facilities in their service territory.

4. CMRS providers gain an inappropriate competitive advantage over IXCs and toll providers.

b) <u>CLEC and CMRS Provider Attempts to Impose Differing Rating and Routing Points or Virtual NPA-NXX Arrangements</u>:

- Supporters of these arrangements are proposing that the Commission allow a local telephone number associated with a CMRS or CMRS switch (rating point) that may be in Oklahoma, in another state in the United States, or for that matter in a foreign country, to be virtually assigned to an ILEC local switch (routing point) in a different state or area. The LEC would be required to allow any end user dialing the virtual number, to be routed via a third party carrier such as SWBT, Qwest, or BellSouth to the CLEC or CMRS switch location where the number actually belongs, whether that is in Oklahoma, in another state, or in a foreign country, on a local-calling, toll free basis.
- These arrangements are inappropriate because they:

  1. Are simply a ruse to avoid legitimate retail tariffed charges for providing interexchange calling. In effect, they are uneconomic toll bypass. They would eliminate toll service provided by IXCs under the Commissions equal access provisions and are at odds with Commission Orders

  2. Destroy the current jurisdictional (local, intrastate, interstate and international) traffic distinctions by inappropriately classifying intrastate toll, interstate toll and international traffic as local and (b) thus cause incorrect intercarrier compensation (local reciprocal compensation rather than interstate or intrastate access).

  3. Require that, on an uneconomic and anti-competitive basis, ILECs transport interexchange calls (as local calls) to any location designated by the CMRS provider or CLEC for free, (b) pay transiting access to all intermediate carriers that transport the calls and (c) pay reciprocal compensation to the

CMRS provider or CLEC for the privilege of providing this free service. These lost revenues and costs, if recovered from ILEC end users, would cause the end users to inappropriately subsidize the competitive services of the CLECs and CMRS providers.

4. Are at odds with existing network routing governed by the LERG. The effect of this inappropriate manipulation and misuse of the LERG is to fool the LERG and LEC local switches into routing interexchange toll calls as local calls.

5. Provide an anti-competitive benefit to CMRS carriers and CLECs. They would be able to obtain free calling and actually gain compensation revenue for interexchange landline to wireless calls, while their competitors, the IXC's, must still charge toll charges to their customers for similar interexchange calls in order to recover their costs of providing their landline to landline service. Additionally, IXC toll providers would further be disadvantaged because they would no longer receive toll revenue for any interexchange virtual NPA-NXX calls. This circumstance would further disincent IXCs from serving rural LEC exchanges that have lower toll volumes than urban exchanges.

Examples Of FCC Interconnection Policies Contributing To The Current Market Failures And Financial Disarray In The Telecommunications Market

1. Access Exemption For ISP Internet Traffic. Access traffic was inappropriately treated as local traffic and subjected to local terminating compensation. Billions of dollars have flowed to CLECs who had no intention of serving residential customers, but were simply allowed by regulators to game the system by serving only ISP's in order to improperly receive terminating compensation from LECs. It is difficult to determine how this benefited consumers, and it clearly harmed the LECs financially. Many of the CLECs and ISPs, however, who apparently the regulators hoped, via the improper subsidies, would actually stay in the market and compete have either taken the money and run, or gone bankrupt.

2. Intercarrier Access Compensation Rates. Access and thus toll rates have been driven to uneconomically low levels through the mistaken notion that these actions would benefit consumers and further competition. Transport costs have been artificially lowered by removing real costs, the "transport interconnection charge". Likewise, the costs of access and toll have been artificially lowered in the "economically efficient" effort to remove subsidies from access and toll rates, and to base these rates on forward looking costs. Real and actual costs of LECs have been ignored in this process, and because they were labeled "subsidies" have been, and continue to be recovered not from toll and access services, but from end user consumers. The result of these manipulations, urged on by LEC competitors through self serving arguments has been inefficient competitive network entry, substantive construction of facilities and overcapacity due to regulatory decisions causing improper market signals, and ultimately the bankruptcies that are now occurring in the telecommunications industry. The effect in the end has harmed most consumers through higher rate levels and may harm LECs through non-payment of access services by bankrupt carriers such as Worldcom.

3. Competitive Interconnection and Facility Rates. The actual cost of competitive entry for CLECs has been artificially manipulated and asymmetric rules favoring CLECs and CMRS providers created in order to attempt to induce "managed" competition. For instance, CLECs are allowed to purchase Unbundled Network

Elements (UNEs), as well as transport and termination facilities at rates that are based on forward-looking costs. These rate levels in no way recover the real cost of the LECs. Similarly, unequal and unfair Eligible Telecommunications Carrier rules which allow CLECs and CMRS providers to receive universal service funds based on LEC and not their own costs, avoid equal access and quality of service obligations and then charge whatever rate they wish to consumers, irrespective of whether that rate is just, reasonable and affordable, is a misuse of universal service funding, and will over time cause the funding required by LECs who really serve customers in rural areas to be unsustainable. Again, these policies, based on self-serving CMRS providers and CLEC rhetoric, have been urged on by competitive carriers. The fruits of these policies are beginning to be clear. CLECs who were artificially incented into the market by regulatory mandated and artificially low entry costs and improperly applied universal service funding are beginning to exit the market through bankruptcies. LECs have been financially harmed because at the artificially low UNE and transport and termination prices, they are unable to recover their real costs of providing facilities. Universal service funding that should flow to offset high network costs of LECs in rural areas is instead being siphoned off by competitors who have no need for this support, and concerns are emerging that the funds may be unsustainable. Again, the losers, as a result of these mistaken regulatory policies are, or will be, rural consumers and the LECs who, as the carrier of last resort, serve these consumers.

The Current Intercarrier Compensation Regime Must Be Supported By The Commission In Order To Avoid Significant Harm To Rural ILECs

1. The current intercarrier compensation regime involving access charges or local reciprocal compensation relies on the following basic premises:
   - The provider selling retail service to an end user customer receives revenues from that customer, which are used to pay for its own, or another carriers network costs of originating, transporting and terminating the customer's call.
   - Bill-and-keep is only appropriate when retail service providers have roughly equivalent levels of network costs and terminating traffic.
   - Bill-and-keep is not appropriate when (a) the providers costs are significantly different, (b) terminating traffic levels are not in rough balance and (c) when the facilities of a carriers that is not the service provider are used by a service provider (IXC, CLEC, LEC or CMRS provider) to originate, transport or terminate its calls.

2. **Rural ILECs obtain approximately 50% in Kansas and 70% in Oklahoma of their total revenue or $60 in Kansas and $85 in Oklahoma, per loop per month from intercarrier compensation.** This compensation is used to:
   - Offset the high cost of providing service in rural areas and thus to aid in the maintenance of just, reasonable and affordable local exchange rates.
   - Provide a high quality, well maintained network.
   - Provide revenues that allow the rural ILEC to upgrade its network and provide broadband facilities and other new technologies for the use of customers connected to its network.

   Without these revenues, rural ILEC local exchange rate levels may rise to unaffordable levels, service quality may deteriorate, new technologies would likely not be provided and it may not be able to continue its COLR responsibilities.

3. **The current intercarrier compensation regime** must be maintained in order to avoid loss of these essential revenues for ILECs and because the regime meets all of the Commission's objectives for a compensation regime. The current regime:

   - **Encourages economic efficiency**. Retail rates reflect all of a calls costs. The service provider uses those revenues to pay its own costs and the network costs of carriers whose facilities are used to complete the call. Retail rates are consequently established at appropriate market levels that insure correct entry and exit market signals are given to competitors.
   - **Encourages investment in interconnected networks and encourages, rather than discourages, broadband investment.** Carriers, both LEC and CLEC, are incented to place appropriate levels of investment (based on traffic levels) and interconnect their networks because they will be paid for the use of their facilities to originate, transport and terminate calls originated by service providers.
   - **Encourages the efficient development of market based rather than contrived competition**. Because appropriate market signals are given as to the costs of completing calls, competitive carriers are able to determine if it is appropriate for them to enter markets and provide service at competitive retail rate levels.
   - **Minimizes regulatory intervention.** The major issues with the current intercarrier compensation regime are rate level issues. The LEC and CLEC access charge proceedings as well as the CMRS and ISP Intercarrier Compensation proceedings have largely resolved these issues. Expediency in the form of bill-and-keep that <u>may</u> minimize regulatory intervention should not be the governing factor in evaluating a compensation regime. Tariffs and contractual arrangements, which are the basis of the current intercarrier compensation regime, will from time to time be the subject of disputes between the parties. The proper way to resolve these disputes is through a review of the agreement by the appropriate regulatory or judicial authority.

This compensation regime does not:

- Create opportunities for regulatory arbitrage. These are created by the FCC and state pricing policies.
- Cause terminating access monopolies. With recent and upcoming access reductions, this is a non-issue.
- Discriminate among differing provider networks. When allowed to operate properly, the current regime would charge all providers (Wireless, wireline, etc.) the same ILECs cost to use necessary facilities.
- Inappropriately incorporate inefficient rates (non-traffic sensitive costs recovered on a traffic sensitive basis) that distort the structure and level of end user rates. To the extent these costs are recovered in FCC and state compensation rates, market based negotiations, rather than FCC intervention, can incorporate mechanisms (i.e., capping compensation payments) to deal with any perceived problems.

Recommendations

1. **The Commission must continue the current intercarrier compensation regime. Do not adopt bill-and-keep for local or access calling**.

Maintenance of and proper application of the current intercarrier compensation regime will (a) avoid the competitive market distortions that occurred with compensation for ISP Internet-bound traffic, (b) avoid subsidization of competitive services by end users, (c) provide appropriate market entry and exit signals to competitors and (d) insure that competitors will not have a disincentive to serve all market segments (residential and business, rural and urban). On the other hand, regulatory intervention to impose bill-and-keep compensation will (a) only promote competition for compensations sake, (b) distort the market, ultimately resulting in a lack of competition and efficiency, particularly in rural areas and (c) harm rural consumers and ILECs.

2. The Commission should clarify its intercarrier compensation policies in Docket No. 01-92 so that state commissions, service providers (competitive and incumbent) and network facility providers have a clear understand of what is required.

The Commission must clarify that (a) rural ILECs are not required to treat intraMTA IXC presubscribed traffic as local ILEC originated traffic, (b) compensation is appropriate when an imbalance of traffic has been demonstrated and (c) that virtual NPA-NXX arrangements are not allowable. These clarifications will preserve the current access compensation regime, avoid severe harm to rural ILECs and their customers and will not harm CLECs or CMRS providers.

3. **The Commission must revise its interconnection costing policies for interconnection in rural ILEC service areas. Rural ILEC interconnection rates must be based on their costs, not forward-looking costs. Competitors should be required to base their rates for rural ILEC interconnection on either their costs or forward looking costs, capped at the rural ILEC level.**

This action (a) will avoid the negative consequences of forward-looking costing that are occurring in non-rural ILEC areas, (b) will insure that rural consumer rates do not subsidize rates of competitive services by allowing rural ILECs to recover their actual costs of interconnection from users of their network facilities, and (c) provides the appropriate costing information to service providers for market entry decisions, and (d) does not create inappropriate or anti-competitive barriers to interconnection for service providers.

4. **Avoid further regulatory imposed access rate reductions for rural ILECs.** Past access rate reductions have contributed to the current instability in the telecommunications market. Further reductions, beyond those already planned, (a) will substantially harm rural customers by further increasing the rates they must pay, (b) are economically inappropriate, (c) are placing substantive pressure on federal and intrastate universal service funding (increasing the funds to unsustainable levels), and (d) are not benefiting consumers but instead are creating an environment in which toll service is unprofitable and service providers are exiting the market